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IV. DEFENSE SPENDING

58. Pakistan's military budget has grown 55% since FY 1972, but there has been little change in real terms.* Allocations for fuel, transport, construction, salaries and other personnel costs have been taking an increasing share of the budget while the proportion allocated for weapons has declined.

Year[a]	Budgeted Military Expenditures[b]	Percent of National Budget
1971	334.3	32
1972	390.4	36
1973	472.6	37
1974	515.5	30
1975[c]	606.5	31

a. Fiscal year ending 30 June of stated year.
b. Million US dollars, converted at 9.9 rupees equal $1.00 US. Includes civilian and meteorological allocations, which for 1975 total $18 million.
c. Preliminary - actual spending will probably be revised upward because of inflation.

59. No important allocations for arms or other military equipment are known to be hidden in the budget. A few military-related expenditures, however, are not reported as defense spending.

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* With domestic expenditures accounting for about 70% of the defense budget, the latter has been greatly affected by domestic inflation. Since FY 1972, Pakistan's wholesale price index has risen 67%. Price increases of domestic goods and services purchased by the military have been somewhat less than those reflected in the wholesale price index.

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For example, the Ministry of Interior Budget reflects civil defense activities such as bomb disposal and civil defense academies. Budgets of other agencies include funds for dual purpose construction projects such as roads. The purchase of food grains for the military at subsidized prices also introduces a slight understatement of the Defense Budget. On the other hand, the inclusion in the Defense Budget for administration of civil projects such as civil aviation and meteorology inflate it.

Foreign Exchange Position

60. Pakistan's foreign exchange outlays for defense imports during FY 1971-1973 ranged from $53 to $151 million a year, about 12 to 18 percent of export earnings. Outlays for FY 1974 could have been relatively less because of the surging petroleum import bill and increasing costs of other essential imports. Net oil imports cost $222 million, nearly four times the preceding year's $57 million. The result was a trade deficit of around $420 million. Other transactions resulted in a payments deficit of $615 million, which was partially covered by aid. The resulting reserve drawdown for FY 1974 is estimated at $184 million as shown below:

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Trade Balance (Million US$)	- 420
Exports	1,030
Imports	-1,450
Debt Payments	- 197
Invisibles and Private Capital Transfers	2
Balance of Payments Deficit	- 615
Financed by:	
Aid	431
Reserve Drawdown and Short-term Borrowings	184

61. The outlook for FY 1975 is for further deterioration in the economic situation, primarily because of mounting inflation and rising import costs. At the same time, prices and demand for Pakistan's exports have declined, increasing the balance-of-payments deficit, probably to about $700 million. As of October 31, 1974, foreign exchange reserves totaled $500 million.

<u>Aid</u>

62. A prospective increase in foreign aid requirements for FY 1975 will be more than offset by recent aid arrangements. The World Bank Consortium on Pakistan has pledged nearly $500 million in aid for FY 1975. The Consortium also rescheduled $650 million in debt repayments over a four-year period and relieved Pakistan of about $400 million of indebtedness for aid projects located in Bangladesh.

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63. Pakistan's military import expenditures in FY 1971-1973 ranged between 12 and 18 percent of export earnings. On this basis, we judge that Pakistan could probably support annual military imports of some $250 million for the next few years. If Pakistan's economic difficulties worsen and if the prices and demand for Pakistan's principal exports continue to decline, this estimate could turn out to be too high. On the other hand, the favorable foreign aid outlook for Pakistan is a counterbalancing factor. To the extent that Islamabad so chooses to orient its priorities, it can devote a substantial portion of the aid it received to

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military purchases. In sum, our estimate that Pakistan could afford military imports of about $250 million annually is rough, but it is the right order of magnitude.

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